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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)
	)
Treatment of Local Exchange Carrier Tariffs Implementing Statement of Financial Accounting Standards, "Employers Accounting for Postretirement Benefits Other Than Pensions"	) CC Docket No. 92-101
	)
Bell Atlantic Tariff F.C.C. No. 1	) Transmittal No. 497
	)
US West Communications, Inc. Tariff F.C.C. Nos. 1 and 4	) Transmittal No. 246
	)
Pacific Bell Tariff F.C.C. No. 1	) Transmittal No. 1597

DIRECT CASE OF
THE SOUTHERN NEW ENGLAND TELEPHONE COMPANY

I. INTRODUCTION.

The Southern New England Telephone Company (SNET) submits this Direct Case in response to the request issued by the Common Carrier Bureau of the Federal Communications

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Commission (Commission) in its Order of Investigation and Suspension.[1]

SNET demonstrates that the mandated accounting change to implement SFAS-106[2] should be recognized as an exogenous cost under the Commission's price cap rules. Further, the assumptions made by SNET in calculating these costs are reasonable, the costs have been correctly calculated, and the allocations of these costs among the price cap baskets are consistent with Commission rules.

In the Commission's Order of Investigation, SNET is named as a party even though it is among those price cap local exchange carriers (LECs) who have not at this point sought exogenous treatment of the costs to implement SFAS-106.[3]

II. SNET SUPPORTS THOSE PARTIES SEEKING TO INCREASE THEIR PRICE CAP INDICES TO REFLECT THE IMPLEMENTATION OF SFAS-106.

Under the Commission's price cap rules, if a mandated accounting change has been ordered by the Commission to be

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[1] Order of Investigation and Suspension, CC Dkt. No. 92-101, DA 92-540, released April 30, 1992 (Order of Investigation).

[2] The Financial Accounting Standards Board (FASB) issued SFAS-106 in December, 1990, which changes the way SNET, and other companies, must account for postretirement benefits other than pensions. See Order of Investigation at para. 2.

[3] Order of Investigation at para. 9, fn. 12 and App. A.

reflected in regulatory accounting, then exogenous treatment should be granted to the extent that there would be no double-counting in the GNP-PI.[4]

SNET has not yet filed tariffs to increase its price cap indices as a result of the implementation of SFAS-106, as have Bell Atlantic, US West and Pacific Bell. SNET agrees with these companies' assertion, contained in their tariff filings, that SFAS-106 clearly meets the test as a FASB-mandated accounting change beyond the control of SNET, and as such, must be considered as an exogenous cost.[5]

III. SNET PROVIDES A GOOD FAITH ESTIMATE OF COSTS TO IMPLEMENT SFAS-106 BY YEAR.

Because SNET has neither indicated to the Commission the date of its intention to adopt SFAS-106, nor filed tariffs to implement SFAS-106, SNET is directed by the Commission to submit good faith estimates of costs.[6]

The assumed implementation date for SNET's adoption of SFAS-106, for the purposes of the submission of this Direct

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[4] Order of Investigation at page 1, fn. 1 and 2 citing LEC Price Cap Order, 5 FCC Rcd 6786 (1990); LEC Price Cap Reconsideration Order, 6 FCC Rcd 2637 (1991); and AT&T Price Cap Reconsideration Order, 6 FCC Rcd 665 (1991). See also Responsible Accounting Officers (RAO) Letter 20, released May 4, 1992 (DA 92-250) by Chief, Accounting and Audits Division.

[5] US West tariff filing of Transmittal No. 246 at page 1-5; Bell Atlantic tariff filing of Transmittal No. 497 at pages 1-4 to 1-7; and Pacific Bell tariff filing of Transmittal No. 1579 at pages 1 to 3.

[6] Order of Investigation at fn. 14.

Case, is January 1, 1993. SNET's actual adoption date will depend, in part, on the FCC's decision in this matter as to the treatment of SFAS-106 as an exogenous cost and as to the recovery in rates.[7]

For the purpose of this Direct Case, Exhibit 1 presents SNET's good faith estimates of costs by year for 1992 and 1993.[8] The data presented in Exhibit 1 reflects a twenty-year amortization period for the SFAS-106 transition obligation.[9] As defined by SFAS-106, the transition obligation is the unrecognized amount, as of the adoption date, of the accumulated postretirement benefit obligation in excess of the fair value of plan assets plus any recognized accrued postretirement benefit cost or less any recognized prepaid postretirement benefit cost.[10]

IV. SNET PROVIDES A GOOD FAITH ESTIMATE OF THE ALLOCATION OF COSTS TO BASKETS BY YEAR.

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[7] The implementation date has not yet been determined. However, should SNET adopt SFAS-106 prior to January 1, 1993, the Commission should approve exogenous cost treatment for 1992. See Order of Investigation at para. 3 and LEC Price Cap Reconsideration Order at para. 61.

[8] Order of Investigation at fn. 14.

[9] SNET has not yet adopted SFAS-106, and thus has not yet selected the amortization period. See also RAO Letter 20, page 2.

[10] SFAS-106, App. E, at page 205.

For the purposes of SNET's Direct Case, Exhibit 2 presents the allocation of the estimated incremental regulated interstate revenue requirements to the price cap baskets. In developing this exhibit, SNET has used the principles set forth by Bell Atlantic, that the appropriate allocation method is based on Total Operating Expenses.[11] SNET agrees with Bell Atlantic that this method is appropriate because total operating expenses encompass all wage-related expenses for Plant Specific, Plant Non-Specific, Customer Operations Marketing, Customer Operations Services, and Corporate Operations, but exclude Depreciation and Amortization which are unrelated to wages. Because costs associated with SFAS-106 are wage-related, this allocation method embodies the principle of cost-causation.

V. SNET RESPONSES TO ORDER OF INVESTIGATION PARAS. 11-16.

(A.) Para 11.4: Citations from SEC Reports:

SNET has not adopted SFAS-106 in either its regulatory reports or its reports to its shareholders or the Securities and Exchange Commission (SEC). In 1991, pursuant to a decision by the State of Connecticut Department of Public Utilities Control (DPUC),[12] SNET established and began to

[11] Bell Atlantic Transmittal No. 497 at pages 4 to 16 and Workpaper 6-44 and Figure 4-11.

[12] DPUC Docket No. 89-12-05, decision dated March 20, 1991, at page 92 and Findings of Fact No. 38.

fund Voluntary Employees' Beneficiary Association (VEBA) trusts, one for management and one for bargaining-unit employees. Fund contributions are equal to the actuarially determined current service cost and interest cost of active employees postretirement health care benefits. These amounts are being expensed in addition to normal pay-as-you-go costs in SNET's SEC reports.[13] See Exhibit 3 for excerpts from SNET's Form 10-K filings with the SEC.

(B) Para 11.5: Studies to Support Exogenous Treatment:

Upon adoption of SFAS-106, SNET's costs for postretirement benefits provided to retirees will almost double.[14] Despite SNET's best efforts to control health care costs, SNET has had to deal with a high rate of medical care inflation.

The intent of the exogenous cost adjustment component of the Commission's price cap formula is to recognize the impact on a carrier's costs of administrative, legislative or judicial actions beyond the control of the carrier.[15] In determining to treat the cost of a particular FASB-mandated change as exogenous, such as SFAS-106, the Commission must

[13] The costs associated with VEBA trusts were not reflected in SNET's base period rates under price cap.

[14] Exhibit 3 at page 20.

[15] LEC Price Cap Order at para. 166.

further determine whether the cost of a particular accounting change is reflected in the GNP-PI, the inflation variable in the price cap index.[16] Clearly, the impact of the adoption of SFAS-106 is both beyond the control of the LECs, and not fully reflected in the GNP-PI.[17]

SNET relies upon the USTA Godwins Study, which demonstrates what percentage of the additional costs incurred as a result of SFAS-106 is reflected in the GNP-PI, and what percentage of these additional costs are unrecovered in the price cap mechanism.[18] The Godwins Study was divided into two parts: an actuarial analysis and a macroeconomic analysis. The actuarial analysis covered all price cap LECs, including SNET. The Godwins Study finds that the increase in GNP-PI caused by SFAS-106 will provide recovery of only 0.7% of the additional costs incurred by price cap LECs.[19] An additional finding of the Godwins Study was that SFAS 106 would have an adjustment in the wage

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[16] AT&T Price Cap Reconsideration Order at para. 74, and LEC Price Cap Reconsideration Order at para. 63. See also US West Transmittal No. 246 at page 1-6.

[17] See USTA's Godwins Study, Executive Summary, submitted as Attachment A to US West Tariff Transmittal No. 246, which demonstrates that price cap LECs would only be able to recover 0.7% of the additional SFAS-106 costs through the price cap inflation adjustment mechanism.

[18] See US West Transmittal No. 246 and Bell Atantic Transmittal No. 497 in relying on the USTA Godwins Study. See also the National Economic Research Associates, Inc. (NERA) Study at pages 2 to 3 submitted by Pacific Bell Transmittal No. 1579. NERA's findings corroborate the Godwins Study in demonstrating the need for exogenous cost recovery of SFAS-106 costs.

[19] Godwins Study, Executive Summary.

rate, accounting for an additional 14.5% recovery of the additional costs as an indirect effect. SNET proposes that 84.8% of its SFAS-106 costs be treated as exogenous.[20]

(C) <u>Para. 13.1: Benefits Covered by SFAS-106:</u>

The benefits provided by SNET that are covered by the requirements of SFAS-106 include: health care, life insurance, dental benefits, and telephone concession.[21]

The SNET Medical plan is available to those who retire with a service or disability pension. The basic medical benefits are for hospitalization, surgical and major medical benefits. Coverage for retirees and their eligible dependents includes home and office visits, prescription drugs, home health care, private duty nursing, inpatient and outpatient surgery, physical therapy, durable medical equipment, chiropractic and podiatric therapy. The Medical Plan also covers inpatient and outpatient psychiatric, psychological and substance abuse therapy. When a retiree reaches age 65, or becomes eligible for Medicare, the SNET Plan becomes secondary to Medicare. Medical Plan coverage

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[20] Id. The net impact of SFAS-106 costs is developed as 100% - 0.7% - 14.5% = 84.8%.

[21] The estimates provided in Exhibit 1 do not reflect any costs associated with telephone concession service. These costs will be evaluated at such time as SNET implements SFAS-106.

continues for the surviving spouses of deceased retirees for a period of six months at SNET's expense.

In addition, SNET provides life insurance to all eligible pensioners; and dental benefits and telephone concession to retirees.

(D) Para. 13.2: Pay-as-you-go level of expense for 1991 and 1992:

As reported in SNET's 1991 Form 10-K (Exhibit 3), pay-as-you-go postretirement benefit expense, at the Plan level, was $18.5 million in 1991. Budgeted pay-as-you-go postretirement benefit expense at the Plan level is $26.1 million for 1992.[22] However, a substantial portion of postretirement benefit cost is related to rate-regulated telephone operations.[23]

(E) Para. 13.3: VEBA trusts established prior to SFAS-106 adoption:

SNET established two VEBA trusts in 1991 pursuant to the decision in the above referenced state regulatory

[22] Pay-as-you-go postretirement benefit expense is shown at the Plan level because benefits are administered for all subsidiaries of the Southern New England Telecommunications Corporation as a group.

[23] For example, of budgeted 1992 pay-as-you-go postretirement benefit expense of $26.1 million, approximately $23.2 million is expected to relate to rate-regulated telephone operations.

proceeding. That decision authorized SNET to begin accruing for the current service cost and interest cost associated with active employees postretirement health care benefits.[24] Funding of these amounts was required by that decision. Tariff rates were approved by the DPUC to provide for recovery of the intrastate portion of these costs. However, as shown below, interstate tariff rates used to enter price caps did not include the interstate portion of the VEBA funding.

(F) Para. 13.4: Adoption of postretirement benefit accrual accounting before price cap:

As stated in the response to para. 13.3, SNET, in addition to expensing pay-as-you-go postretirement benefit costs, is also accruing amounts related to the two VEBA trusts established in 1991.

[24] SNET began accruing for these costs on April 1, 1991.

(G) <u>Para. 13.5: SFAS-106-type expenses reflected in current rates and Para. 13.6: SFAS-106 type expenses reflected in starting rates for price cap:</u>

SNET's initial rates under price cap,[25] were based on SNET's annual 1991 interstate access tariff filing. In that filing, SNET used the pay-as-you-go method of accounting for postretirement benefits. Further, this amount was substantially less than the level of pay-as-you-go expense expected to be experienced in 1992 and 1993.[26] SNET has not made any adjustments to its initial price cap rates for any amounts related to SFAS-106, nor to the establishment of VEBA trusts in 1991.

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[25] SNET elected price caps effective July 1, 1991.

[26] <u>See</u> Exhibit 1.

(H) Para. 14: Descriptions and justifications of the actuarial assumptions:

SNET's actuarial assumptions under SFAS-106 are provided in Exhibit 4.

SNET has relied on the Godwins Study, as cited in the response to the Order of Investigation para. 11.5, which provides the actuarial assumptions to develop the cost impact of SFAS-106. The Godwins Study does not contain any explicit assumptions about National Health Insurance. The prospect of National Health Insurance has been discussed in Congress for at least the past decade. While SNET recognizes that National Health Insurance is a prospect for the future, there is no way to predict if and when it will be implemented. Further, it is not likely that the implementation of such a program would reduce SNET's medical care liability immediately.

Although SNET capped some of its postretirement medical liability in 1989, these caps do not go into effect until 1996, and apply only to retirees who retired after the caps were put into effect.[27]

[27] Caps are in effect for bargaining unit employees retiring after 1989 and management employees retiring after 1991. Caps do not affect dental or life insurance, or telephone concession.

(I) Para. 15: Double counting - GNP-PI:

As shown in Godwins Study, only 0.7% of the additional SFAS-106 costs of the price cap LECs will be reflected in the growth of the GNP-PI.[28] SNET's good faith estimate of the costs to implement SFAS-106 included this 0.7% adjustment. Therefore, SNET's calculation of the exogenous cost change for SFAS-106 did not include any double-counting.

(J) Para. 16: Describe and document USTA macroeconomic model:

A point-by-point response to the issues raised in para. 16 is provided in the Direct Case of the United States Telephone Association (USTA), filed June 1, 1992. USTA's Direct Case contains the requested information to evaluate the macroeconomic model in the Godwins Study. This model is not designed to forecast the actual level of GNP-PI, but instead is designed to estimate the change in the level of the GNP-PI that results from the introduction of SFAS-106.

[28] See Godwins Study, Executive Summary; pages 7 to 11; and Section III, pages 12 to 31.

VI. CONCLUSION.

SFAS-106 is a mandated accounting change to be implemented for regulatory purposes by order of the Commission. SNET urges that the change in accounting necessary to implement SFAS-106 should be recognized as an exogenous cost change under the Commission's price cap rules. In support of this assertion, SNET and other price cap LECs have submitted studies that demonstrate the impact of SFAS-106 on LECs as a composite whole, and on the GNP-PI. SNET has met the burden of demonstating that this is an appropriate exogenous change and that no double-counting would result from exogenous treatment. Therefore, SNET requests a favorable finding by the Commission that exogenous treatment is appropriate for costs attributable to SFAS-106 within price cap guidelines.

Respectfully submitted,
THE SOUTHERN NEW ENGLAND TELEPHONE COMPANY

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June 1, 1992

CERTIFICATE OF SERVICE

I, Melanie Raycroft, do hereby certify that on this 1st day of June 1992, a copy of the foregoing Direct Case was served by first class U.S. mail, postage prepaid, to the parties on the attached service list.

Melanie Raycroft

Melanie Raycroft

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CC Docket No. 92-101

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SNET
ESTIMATED COSTS BY YEAR

IMPLEMENTATION DATE:	(Dollars in Millions) JAN 1, 1992	JAN 1, 1993
Gross SFAS No. 106 Cost With 20 yr Amortz	$41.1	$41.3
Percent of Costs Expensed	90%	90%
Gross Expense Impact	37.0	37.2
Projected Pay-as-you-go Amounts	23.2	26.0
Net Expense Impact Before Separations	$13.8	$11.2
Rate Base Impact:		
Plant-in-Service	$ 4.1	$ 4.1
Deferred Tax Impacts	4.1	2.9
Accrued SFAS No. 106 Cost	(9.8)	(6.9)
Net Rate Base Impact	$(1.6)	$ (.1)
Interstate Total Access Net Expense After Separations:	$ 2.9	$ 2.3
Interstate Total Access Rate Base Impact on Revenue Requirement	(.1)	(.0)
Interstate Revenue Requirement Impact	$ 2.8	$ 2.3

EXHIBIT 2

ESTIMATED 1992 AND 1993 EXOGENOUS COSTS FOR SFAS-106

(DOLLARS IN MILLIONS)

	REVENUE REQUIREMENT IMPACT	SFAS-106 EXOGENOUS (GODWINS)	EXOGENOUS AMOUNT	DISTRIBUTION OF TOTAL OPERATING EXPENSES*	JANUARY 1, 1992 ALLOCATED EXOGENOUS AMOUNT
INTERSTATE	$2.8	84.8%	$2.4	100%	$2.4
COMMON LINE	-			40%	$1.0
SWITCHED	-			47%	$1.1
SPECIAL ACCESS	-			13%	$0.3

	REVENUE REQUIREMENT IMPACT	SFAS-106 EXOGENOUS (GODWINS)	EXOGENOUS AMOUNT	DISTRIBUTION OF TOTAL OPERATING EXPENSES*	JANUARY 1, 1993 ALLOCATED EXOGENOUS AMOUNT
INTERSTATE	$2.3	84.8%	$2.0	100%	$2.0
COMMON LINE	-			40%	$0.8
SWITCHED	-			47%	$0.9
SPECIAL ACCESS	-			13%	$0.3

* - Based on 1991 actual results from the Southern New England Access Cost System (SNACS).

EXHIBIT 3

EXCERPTS FROM

THE SOUTHERN NEW ENGLAND TELEPHONE COMPANY

1991 FORM 10-K, FILED MARCH 25, 1991

PAGES 19, 20, 30 AND 31

~~because a significant portion of current-year revenues reflect contracts~~ entered into in the prior year. Management expects that revenues from directory publishing for 1992 as compared with 1991 may decline. Revenues from billing and collection services decreased $4.0 million in 1991 primarily as a result of interexchange carriers electing to perform more of these services for themselves.

COSTS AND EXPENSES

Total costs and expenses, excluding interest, were $1,097.1 million in 1991 as compared with $1,084.6 million in 1990. For 1991, total costs and expenses include a $33.9 million before-tax charge relating to the cost of two voluntary separation offers, one for bargaining-unit employees and one for management employees, as discussed in Note 5 to the financial statements. Total costs and expenses for 1990 include a $33.8 million before tax charge relating to a reduction in the realizable value of accounts receivable, as discussed in Note 2 to the financial statements.

Operating and maintenance expenses of $775.1 million increased $11.7 million, or 1.5%, in 1991. These costs are composed primarily of wages and salaries, and pension and other employee-benefit costs.

Wage and salary costs decreased $2.8 million, or .7%, in 1991. The decrease in wage and salary costs in 1991 is primarily a result of a 5.6% reduction in the average workforce. The average workforce was reduced primarily through the two voluntary separation offers, which resulted in approximately 1,000 employees leaving the Telephone Company during the last half of 1991. Substantially offsetting the effect of the decrease in the average workforce was an increase in various incentive-pay plan accruals and increases in bargaining-unit and management employee wage and salary rates. Compensation under management and bargaining-unit incentive plans increased $6.0 million in 1991 primarily because the Corporation attained a higher percentage of its corporate objectives than in 1990. Bargaining-unit employees received a 3.0% and 4.5% wage increase in September 1990 and December 1991, respectively, in accordance with a contract negotiated in 1989. Bargaining-unit rates will remain at their current levels until March 1993 when the contract expires. Management employees received a 4.0% wage increase effective in April 1991.

As a result of the decreases in the Telephone Company's average workforce discussed above, and similar such decreases in prior years, the number of Telephone Company employees per ten-thousand network access lines has declined from 73 at December 31, 1987 to 53 at December 31, 1991.

The Telephone Company participates in the Corporation's pension and other employee benefit plans and is allocated a portion of these costs based on the relative number of Telephone Company employees to total employees participating in these plans. Its portion of the Corporation's pension and benefit costs was approximately 90% in 1991 and 1990. Pension and other employee benefit costs of the Corporation increased $18.3 million, or 13.5%, ~~in 1991, exclusive of costs related to the voluntary separation offers.~~ Effective April 1, 1991, the Corporation began to provide for the current service and interest cost of active employees' postretirement health care benefit obligation, in accordance with the Phase I - Final Decision (See Item 1., "State Regulatory Matters"). The costs of these benefits, which totaled $6.7 million for the period April 1, 1991 to December 31, 1991, have been contributed to Voluntary Employees' Beneficiary Association ("VEBA") trusts. Also in 1991, savings plan costs increased $6.9 million over 1990. This increase is primarily a result of costs associated with a leveraged Employee Stock Ownership Plan ("ESOP"). The ESOP, which became effective on September 1, 1990, was established to provide employees with an improved savings plan benefit in a cost-effective manner and to give employees a greater stake in the Corporation. Health care benefits increased $4.0 million, or [illegible]%, in 1991 reflecting primarily the nationwide trend of rising medical costs despite cost-containment efforts by the Corporation in this area. As discussed in Note 5, the Corporation has reserved the right to require, beginning on July 1, 1996, certain retirees to share premium costs of health care benefits if these costs exceed certain limits. Management continues to seek additional means to effectively manage its obligation for health care benefits for both active and retired employees consistent with its commitment to provide employees with a competitive benefits package.

In December 1990, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." SFAS No. 106 requires that employers accrue, during the years employees render service, the expected cost of benefits provided to employees and their eligible dependents upon retirement. Upon adoption, SFAS No. 106 permits an employer the option of recognizing the unfunded accumulated benefit obligation for postretirement benefits (referred to as the "transition obligation") immediately or over the average remaining service period of active employees. An analysis of the statement indicates that the Corporation's estimated transition obligation upon adoption will be between $300 million and $350 million, and that expense recognized under the new standard could be as much as two times the current level recorded for these benefits, including VEBA fund contributions. SFAS No. 106 must be adopted by the Corporation no later than January 1, 1993. Management has not yet decided when to adopt SFAS No. 106 or by which method to recognize the transition obligation. The degree to which Federal and state regulatory authorities allow the recovery of these costs in rates also has not been determined as yet. Management has been pursuing, and will continue to pursue, recovery in rates of the portion of these costs that relate to rate-regulated operations.

Depreciation and amortization expense increased $.1 million in 1991. The increase in depreciation and amortization expense is due primarily to an increase in the Telephone Company's depreciation rates for intrastate plant, effective March 20, 1991. The Telephone Company implemented the depreciation rate increase in accordance with a December 1990 DPUC decision granting an increase in annual depreciation of approximately $11 million based on December 1990 plant levels. Pursuant to an agreement approved by the DPUC in January 1991 between the Telephone Company and other parties to the proceeding, the new rates were implemented coincident with the Phase I Final Decision. Substantially offsetting the effect of the increased depreciation rates was the absence in 1991 of amortization associated with inside wiring, which was completed in December 1990. Amortization of inside wiring costs for 1990 was $14.6 million.

~~Funding of the plans is achieved through irrevocable contributions made to~~ a trust fund. The Corporation's policy is to fund pension cost for these plans in conformity with the Employee Retirement Income Security Act of 1974 using the aggregate cost method. For purposes of determining contributions, the assumed investment earnings rate on plan assets was 11.0% in 1991 and declines to 6.0% by 1998.

The Telephone Company's portion of the Corporation's pension cost (credit) computed using the projected unit credit actuarial method was approximately \$16.6 million, \$(.4) million and \$(6.4) million for 1991, 1990 and 1989, respectively. Pension cost increased in 1991 primarily as a result of the VMO discussed above. Pension cost increased in 1990 primarily as a result of a decrease in the rate used to discount the projected benefit obligation and from the full year's effect of benefit increases granted under the bargaining-unit contract negotiated in September 1989.

Plan assets consist primarily of listed stocks, corporate and governmental debt, and real estate. When it is economically feasible to do so, the Corporation amends periodically the benefit formulas under its pension plans. Accordingly, pension cost has been determined in such a manner as to ~~anticipate that improvements in the pension plans would continue~~ in the future.

<u>Postemployment Health Care and Life Insurance Benefits</u>: The Telephone Company participates in the health care and life insurance benefit plans for retired employees provided by the Corporation. Substantially all of the Telephone Company's employees may become eligible for these benefits if they retire with a service pension. In addition, an employee's spouse and eligible dependents may become eligible for health care benefits. Life insurance benefits are paid from a fund to which the Corporation suspended contributions in 1984 in accordance with an actuarial analysis of the assets and liabilities of the fund. Health care benefits are paid from company funds and are expensed when paid (referred to as the "pay-as-you-go" method). Pay-as-you-go cost for these benefits for the Corporation in 1991, 1990 and 1989 was \$18.5 million, \$16.0 million and \$13.5 million, respectively. Substantially all of these costs relate to benefits provided to retirees of the Telephone Company. Effective July 1, 1996, all bargaining-unit employees who retire after December 31, 1989 and all management employees who retire after December 31, 1991 may have to share with the Corporation the premium costs of health care benefits if these costs exceed certain limits.

Effective April 1, 1991, the Corporation began to provide for the current service cost and the interest cost of active employees' postretirement health care benefits, in accordance with a DPUC March 20, 1991 final decision in a rate proceeding. These costs totaled \$6.7 million for the nine months ended December 31, 1991 and have been contributed to Voluntary Employees' Beneficiary Association ("VEBA") Trusts.

The Corporation has not yet adopted SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," which was issued by the Financial Accounting Standards Board ("FASB") in December 1990. SFAS No. 106 requires that employers accrue, during the years an employee renders service, the expected cost of health care and other non-pension benefits provided to retirees and their eligible dependents. An analysis of the statement indicates that the Corporation's initial liability upon adoption of SFAS No. 106, which can be either recorded immediately or amortized over the average remaining service period of active employees, or 20 years if longer, is between approximately $300 million and $350 million. A decision has not been made regarding whether the initial liability will be recorded immediately or amortized. This decision will be based, in part, on the degree to which regulatory recovery of SFAS No. 106 costs will be provided through rates. Management anticipates that periodic postretirement benefit expense under SFAS No. 106 could be as much as two times the current level of expense, including VEBA trust contributions, for the same period depending on the method of adoption. The statement is required to be adopted by the Corporation and the Telephone Company no later than for its fiscal year beginning January 1, 1993.

Note 4. Provision for Income Taxes

The provision for income tax expense includes the following components:

Dollars in millions, for the years ended December 31,	1991	1990	1989
FEDERAL			
Current	$ 63.4	$ 41.5	$ 58.5
Deferred	1.5	17.2	27.8
Investment tax credits, net	(7.1)	(8.5)	(8.6)
Total Federal	57.8	50.2	77.7
STATE			
Current	29.7	12.9	22.6
Deferred	5.3	21.6	21.1
Total State	35.0	34.5	43.7
Total Provision for Income Taxes	$ 92.8	$ 84.7	$121.4

Deferred income tax expense results primarily from timing differences involving accelerated tax depreciation and shorter tax lives for income tax purposes. In 1990, significant deferred income taxes also arose from the immediate deduction for income tax purposes of the portion of the Telephone Company's final gross earnings tax payment ("GET") deferred to future year expense for accounting and ratemaking purposes.

In accordance with regulatory accounting practices in effect prior to 1988, the Telephone Company did not provide deferred income taxes for certain timing differences (items b. and e. below) arising prior to 1988 because the ratemaking process assures their recovery, when paid, through future revenues. The cumulative net amount of income tax timing differences for which deferred income taxes have not been provided at December 31, 1991 was approximately $132 million and relates principally to the capitalization of certain general overhead, taxes and payroll-related construction costs for financial statement purposes.

Actuarial Assumptions

SNET Retiree Health Plans
FAS 106
Key Assumptions

I. Healthcare Cost Trend Rates

A. Medical Care Trend Rates for pre-1990 Retirees

	Pre-65	Post-65
1992	11.4%	5.0%
1993	10.9%	5.7%
1994	9.9%	8.1%

For 1995 and beyond the medical care trend rate declines from the 1994 levels.

B. Part B Trend Rates for pre-1990 Retirees

1992	6.4
1993	15.1
1994	12.3

For 1995 the Medicare Part B trend rate declines.

C. Dental Trend Rates for Retirees and Actives (Management and Nonmanagement)

1992	9.0
1993	8.5
1994	8.0

For 1995 and beyond the dental trend rate declines.

II. 1991 Per Capita Claim Cost (including insurance company retentions)

Plan	100% Coverage	80/20 Copay
Medical		
Pre-65	$4,707	$4,293
Post-65	$1,570	$1,411
Part B	$ 526	$ 526
Dental	$ 285	$ 285

III. Salary Increases: 5% Plus Progression and Promotion

IV. Discount Rate: 8%